



Irving Trust

Financial Markets

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Economic Research &
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Friday
(Noon)

Feb. 24, 1984

The marketplace experienced a series of setbacks in February leading to utter frustration. Since early February, three-month CDs have increased their yields by 45 basis points; the long bond is back nearly 50 basis points; and Fed funds have risen by a meager 12 basis points. Thus the Fed cannot be said to be at the bottom of this. The money markets have moved in advance of the Fed, indicating a change of expectations.

There have been a few fundamental changes. Certainly the revision of the money stock data for 1983 counts as a fundamental. The monetary picture is different now, with M1 growth stronger overall, particularly in the second half of the year. The economy is the second changed fundamental, more important than money. But the economic data have been greatly affected by weather problems: They looked too weak in December and too strong in January. Slow growth in money had provided a safety net; presumably the Fed could not tighten with weakness in the aggregates. Now the safety net has been removed. But when this is combined with the "stronger" economy, it does not suffice to explain why the market has moved so much.

The answer is really in the development of market psychology. Mr. Volcker's testimony was catalytic. It painted a picture of risks, and now market participants fear that all the worst will happen at once: Interest rates will rise, inflation will kick up, the dollar will decline, the budget deficits will remain large, and so will our deficit on current account. While some combination of these "bad" events could occur, all cannot happen simultaneously. But because there is no clear solution, participants are fearing the worst. This is in some way irrational. The policy trade-offs are difficult, but they do exist. We need to identify the priorities (those likely to be acted on) and see what repercussions are likely.

In this regard, I feel that the long-run inflation outlook is much better than the bond market thinks. Twelve percent-plus for 30 years is going to make a handsome return relative to inflation. Gridlock on the budget deficit is a problem. And it's easy to see how skeptical market participants might see inflation as one possible solution the government could pursue to settle its debts. But the scheduled indexing of tax brackets makes this course one of lesser payoff. Moreover, Mr. Volcker's testimony dwelt on the inflation problem and the need to keep the pressure on. Too much effort has already been expended fighting inflation for it to be for naught. Inflation will be kept in check. At the same time, the Fed will try and keep interest rates from moving to excessive heights. This should provide some reassurance. Thus there is risk of higher interest rates, but not significant increases until budget deficits clash with an economy facing capacity constraints that could begin to stimulate inflation. We need not harbor such fears now. The economy has a number of unsolved problems, but that's not cause enough to fear that everything will go wrong. We should have more trust in monetary policy and hope for a changed fiscal policy. In the meantime, let's not overdo the fear of deficits at this stage in the expansion.

Robert A. Brusca



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Market Yields

	2/24/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00	11.00%	11.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	8.50
Federal Funds	9.63	9.50	8.13
Repurchase Agreements	9.35	9.35	8.05
U.S. Treasury Issues			
Bills			
3 months	9.53	9.46	8.13
6 months	9.89	9.86	8.29
1 year	10.19	10.17	8.58
Coupons			
2 years	10.98	10.84	9.28
4 years	11.48	11.36	9.72
7 years	11.88	11.75	10.19
10 years	11.99	11.87	10.25
Long Bond	12.12	11.98	10.47
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.55	9.52	8.15
3 months	9.65	9.75	8.25
6 months	9.90	9.85	8.35
1 year	10.25	10.35	8.90
Banker's Acceptances			
1 month	9.60	9.55	8.10
3 months	9.75	9.70	8.20
6 months	9.97	9.94	8.35
Eurodollar Deposits			
1 month	9.94	9.88	8.88
2 months	10.13	10.00	8.94
3 months	10.25	10.13	8.94
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.50	9.55	8.12
1 month	9.66	9.61	8.17
3 months	9.65	9.60	8.28
Bank Holding Companies			
1 month	9.07	8.94	8.31
Dealer Placed:			
3 months	9.77	9.76	8.41
New AA Corporate Utility Bond	13.15	13.05	11.85
Tax Exempt			
6 month Project Notes	5.25	5.15	4.00
1 year AAA Bond	5.70	5.50	4.50
5 year AAA Bond	6.90	7.00	6.20
20 year AAA Bond	9.10	9.00	8.65

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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